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No. 05-996

Supreme Court
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IN THE

# Supreme Court of the United States

ROBERT LOUIS MARRAMA,

*Petitioner,*

*v.*

CITIZENS BANK OF MASSACHUSETTS, and
MARK G. DeGIACOMO, CHAPTER 7 TRUSTEE,

*Respondents.*

**ON WRIT OF CERTIORARI**
**TO THE UNITED STATES COURT OF APPEALS**
**FOR THE FIRST CIRCUIT**

## REPLY BRIEF

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## ARGUMENT

The language of section 706 of the Bankruptcy Code is unambiguous: "the debtor may convert a case under this chapter to a case under chapter 11, 12, or 13 of this title at any time, if the case has not been converted under §§ 1112, 1208 or 1307 of this title. . . . Notwithstanding any other provision of this section, a case may not be converted to a case under another chapter of this title unless the debtor may be a debtor under such chapter." This language carries as clear a negative inference as any language can — there is no *other* basis for denying conversion.

Respondents and their *amici* invoke a much-exaggerated parade of "horribles" to illustrate why this Court should disregard the clear statutory meaning, and permit bankruptcy courts to deny conversion of a chapter 7 case to another chapter on the grounds of bad faith. Their reasoning, however, would have the *general* and *residual* authority granted in section 105(a) of the Bankruptcy Code trump the *specific* provisions of section 706(a). They do so in order to provide an *additional* remedy for the problem of the bad faith debtor—a problem that Congress expressly contemplated and addressed in other provisions of the Bankruptcy Code.

The truth of the matter is that the expansive, nearly limitless, authority that some bankruptcy courts believe that Congress conferred on them in section 105(a) of the Bankruptcy Code —a power to all but disregard the plain meaning of the Code when their own vision of "bankruptcy policy" runs contrary to what Congress has provided — is an important and recurring theme in bankruptcy appeals, and a matter that the courts of appeals have been required

to address with increasing frequency. A decision by this Court that broadly relies on the background section 105(a) power as a basis to disregard the plain language of the Code would reinforce the notion that bankruptcy judges are authorized to achieve whatever result they consider "equitable," notwithstanding clear and contrary statutory language.

That is not and should not be the law. In order to address the indisputably important problem of abuse by individual debtors, bankruptcy courts require no more authority than Congress actually granted them. While one could certainly imagine a Bankruptcy Code that *also* provided the specific judicially-created protections that were fashioned here, the task of so amending the Code is one that should be left to Congress.

## I. THE "INHERENT AUTHORITY" OF A COURT DOES NOT PERMIT IT TO DISREGARD THE PROVISIONS OF STATUTES OR RULES.

Respondents and their *amici* rely largely on this Court's decision in Chambers v. NASCO, Inc., 501 US 32, in support of the proposition that a bankruptcy court has "inherent authority" to deny conversion, notwithstanding the clear language of 11 USC § 706.

In fact, Chambers strongly supports petitioner's position. Chambers involved a litigant who had not only filed pleadings that would have been subject to sanctions under Rule 11, he also engaged in "bad-faith conduct [that] was beyond the reach of the Rules." Id. at 50-51. In that circumstance — one in which "the conduct at issue is not covered by one of

the other sanctioning provisions," id. at 50 — a 5-4 majority of this Court, per Justice White, held that it was permissible to rely on the background inherent power. Four dissenting Justices, however, faulted the majority for its "failure to require reliance, when possible, on the panoply of express sanctioning provisions provided by Congress." Id. at 61 (Kennedy, J., joined by Rehnquist, C.J., and Souter, J., dissenting). *See also* Id. at 60 ("A court must use the prescribed means unless for some reason they are inadequate.") (Scalia, J., dissenting).

Chambers, at bottom, stands for the unremarkable principle that inherent power may *supplement* the powers afforded by statutes or rules when the statutes or rules are inadequate. "It is true that the exercise of the inherent power of lower federal courts can be limited by statute and rule, for '[t]hese courts were created by act of Congress.'" Id., *quoting* Robinson, 19 Wall., at 511. Most tellingly, the Chambers court stated:

> A court must, of course, exercise caution in invoking its inherent power. . . . [W]hen there is bad-faith conduct in the course of litigation that could be adequately sanctioned under the Rules, the court ordinarily should rely on the Rules rather than the inherent power.

This Court's decision in Carlisle v. U.S., 517 U.S. 416 (1996), is to the same effect. The question in Carlisle was whether a district court could grant a defendant's motion for acquittal, notwithstanding that the motion was filed one day *after* the deadline for doing so as defined by Fed.R.Crim.Pro. 29. This Court held that it could not, and that the holding in

Chambers was of no help to the petitioner. "Whatever the scope of this 'inherent power,' however, it does not include the power to develop rules that circumvent or conflict with the Federal Rules of Criminal Procedure." Nor did the background power reflected in the All Writs Act require a different outcome. "The All Writs Act is a residual source of authority to issue writs that are not otherwise covered by statute. Where a statute specifically addresses the particular issue at hand, it is that authority, and not the All Writs Act, that is controlling." Id. at 429. *See also* Br. of the United States in Carlisle v. United States, 1995 WL 728581 at * 31-32 ("The All Writs Act is a residual source of authority to issue writs that are not otherwise covered by statute. Where a statute specifically addresses the particular issue at hand, it is that authority, and not the All Writs Act, that is controlling. Although that Act empowers federal courts to fashion extraordinary remedies when the need arises, it does not authorize them to issue ad hoc writs whenever compliance with statutory procedures appears inconvenient or less appropriate.").

This Court has applied the same logic in the bankruptcy context. In Taylor v. Freeland and Kronz, 503 U.S. 638, 112 S. Ct. 1644, 118 L. Ed. 2d 280 (1992), the Court held that the requirement of a timely objection to a debtor's claim of exemptions could not be altered by allegations of a debtor's bad faith in claiming the exemption, and that if bad faith was actually present, it could be remedied without violating the plain language of the Rule. Id. ("We have no authority to limit the application of §522(l)

to exemptions claimed in good faith."). The same principle controls here. The court's inherent power must be exercised with caution, discretion and restraint, and not in derogation of applicable statutes or rules.

## II. SECTION 105 OF THE CODE CANNOT BE APPLIED IN THE MANNER PROPOSED BY THE RESPONDENTS.

The invocation of §105 adds nothing to the respondents' analysis. That provision was derived from the All Writs Act, 28 USC §1651, and as such is a residual source of supplemental authority, *see, e.g.*, In re Combustion Engineering, 391 F.3d 190, 225 & n.36 (3rd Cir. 2004); Palmer v. United States 219 F.3d 580, 582 n.2 (6th Cir. 2000), and by no means is an open-ended license to disregard the explicit command of a statute or rule. Accordingly, this Court has made clear that "whatever equitable powers remain in the bankruptcy courts must and can only be exercised within the confines of the Bankruptcy Code." Norwest Bank Worthington v. Ahlers, 485 US 197 (1998).

If anything, a practical understanding of the issues commonly presented in bankruptcy litigation and bankruptcy appeals demonstrates that one important form of "abuse" of the bankruptcy process derives from the view that section 105 may authorize a bankruptcy court to enter any order or take any action that it believes will facilitate a corporate reorganization, without regard to the language of the Bankruptcy Code. For example:

- In In re Kmart Corp., 359 F.3d 866,871 (7th Cir. 2004), the bankruptcy court entered an order

authorizing the debtor to pay, immediately and in full, the claims of certain so-called critical vendors, notwithstanding the Code's specific (and contrary) rules about priority and distribution. The ostensible authority for this action was the "doctrine of necessity," a doctrine (not unlike the principle of preventing abuse invoked by respondents herein) that was said to be grounded in section 105. The Seventh Circuit reversed. "The fact that a [bankruptcy] proceeding is equitable does not give the judge a free-floating discretion to redistribute rights in accordance with his personal views of justice and fairness, however enlightened those views may be. A 'doctrine of necessity' is just a fancy name for a power to depart from the Code. Although courts in the days before bankruptcy law was codified wielded [such] power . . . in the name of "necessity"[,] today it is the Code . . . that must prevail."

• Section 524(g) of the Bankruptcy Code authorizes, in certain circumstances, a bankruptcy court to channel to an asbestos trust claims for asbestos-related bodily injury that run against non-debtors, such as corporate affiliates. One of the important limitations, however, is that such relief can be granted only with respect to claims that are *derivative* of claims against the debtor. In In re Combustion Engineering, 391 F.3d 190, 236 (3rd Cir. 2004), the bankruptcy court concluded that it would facilitate the corporate reorganization also to channel *non-derivative* liability. It found in section 105(a) the authority to grant such relief. The Third Circuit reversed. "The general grant of equitable power contained in § 105(a) cannot trump specific provisions of the Bankruptcy Code, and must be

exercised within the parameters of the Code itself. When the Bankruptcy Code provides a specified means for a debtor to obtain a specific form of equitable relief, those standards and procedures must be observed." *See also* Resorts Int'l v. Lowenschuss, 67 F.3d 1394, 1402 (9th Cir.1995) ("Section 105 does not authorize relief inconsistent with more specific law").[1]

Even leaving aside the practical consequences that a broad ruling by this Court on the meaning of section 105 might have on the application of the rule of law in bankruptcy courts, traditional tools of statutory construction — and the principle that a specific provision must trump a general one — counsel strongly against the respondents' position. The negative inference arising from the language of section 706(a) is clear. This specific expression of congressional intent must surely prevail over the general background of equitable power reflected in section 105(a).

## III. FOLLOWING THE PROCEDURE ESTABLISHED BY THE STATUTE AND THE APPLICABLE RULE DOES NOT EXALT FORM OVER SUBSTANCE.

The respondents also argue that it would exalt form over substance to require conversion to chapter

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[1] Notwithstanding the statements in the Government's brief about the role of the Office of the U.S. Trustee as a "watchdog" to prevent "overreaching" in the bankruptcy arena, Br. of U.S. at 1-2, that Office has not exercised nearly the vigilance in guarding against "overreaching" in the context of corporate reorganizations that it has in the context of individual debtor cases. For example, it raised no objection to the "overreaching" criticized by the courts of appeals in either of the cases cited above.

13 only to have the case converted back to chapter 7 because of bad faith in filing a plan, 11 USC §1325(a)(3). But the fact that the Bankruptcy Code provides *another* means of addressing the problem presented by debtors who convert their cases to chapter 13 in bad faith is a reason to *adhere* to the design set in the statute by Congress, not a reason to depart from it.

The scheme set out by Congress merely gives every debtor who exercises the right to convert a case to chapter 13 an *opportunity* to seek to persuade a bankruptcy court that proceeding in chapter 13 is appropriate and that he will be able to pay his creditors more under a chapter 13 plan than they would be paid in chapter 7. There is certainly no assurance that the bankruptcy court will be persuaded by that argument. While in the ordinary case it would be appropriate for the bankruptcy court to give a debtor the opportunity to present a chapter 13 plan — which under the Bankruptcy Rules must be filed within 15 days of filing or conversion, Fed.R.Bankr.Pro. 3015(b) — so that the question of good faith can be examined in a concrete context, the statute contains no *per se* prohibition, in an exceptional case, against bringing the question of "good faith" to a hearing on an even more expedited basis.[2]

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[2] While the case law addressing the question of what constitutes the type of "bad faith" that would justify the conversion or dismissal of a bankruptcy case is less than entirely uniform, the better reasoned cases focus the enquiry on the debtor's basic honesty of purpose. *See* Keach v. Boyajian (In re Keach), 243 B.R. 851 (1st Cir. BAP 2000). Specifically, the court in Keach noted that the primary focus should be on post-petition events, and whether the plan complies with the other requirements of the Code. The panel concluded that it was error for the bankruptcy court in

At bottom, the petitioner here seeks only the narrow right that Congress has unambiguously granted him — the chance to convert his case to one under chapter 13, and seek to persuade the bankruptcy court and his creditors — through the submission of a valid and confirmable chapter 13 plan — that it belongs there.

The decisions below — which denied the petitioner even the opportunity to argue that his chapter 13 plan would best serve the interests of his creditors — effectively arrogated to the court a public policy decision made by Congress. After all, it is Congress that decided what kind of debts may be discharged, and whether some debts would be dischargeable in chapter 13 but not in chapter 7. It is not bad faith to seek a remedy that Congress has granted. *See* In re Croston, 313 B.R. 447 (9th Cir. BAP 2004), *citing* Street v. Lawson (In re Street), 55 B.R. 763 (9th Cir. BAP 1985) ("neither conduct nor motive vitiates the absolute nature of the right to convert;" conversion after a judgment of non-dischargeability is not "manipulation of the Bankruptcy Code"); In re Miller, 113 B,R, 98 (Bkrtcy.D.Mass. 1990) (In Massachusetts, declaring a homestead exemption is not a fraudulent transfer because it is not a "transfer" at all and is expressly permitted by statute; it is not "bad faith" to do what the law allows).

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that case to deny confirmation *inter alia* based on what the bankruptcy court perceived to be an inadequate dividend to general unsecured creditors; rather, so long as the dividend fulfilled the requirements of 11 USC §1325(a)(4), confirmation may not be denied based on the bankruptcy court's perception of the debtor.

Again, the bankruptcy court may or may not be persuaded that the petitioner's plan was in fact filed in good faith and would be in the best interest of his creditors. But against that backdrop, the fact that a chapter 13 case can be converted back to chapter 7, on the grounds of a debtor's bad faith, is a *solution* to the problems that respondents identify, and surely is not a reason to disregard the congressional design on the ground that they deem it to be less efficacious than one that they might have designed themselves.

The discretion-conferring approach to interpretation of the statute is not only contrary to its plain language, it inserts into the process the element of unpredictability. That is, if the right to convert from chapter 7 to another chapter can be denied on unwritten, subjective, "totality of the circumstances" grounds, no debtor and no debtor's attorney will know under what circumstances conversion will be allowed or whether the debtor will be punished for seeking conversion in circumstances that a court believes constitute "bad faith".[3]

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[3] Neither respondent nor their *amici* have posited a clear standard for determining bad faith, which is necessary in order to lend predictability to the process. Neither does a review of decisions of lower courts suggest a standard that this Court could establish. *Compare* In re Porter, 276 B.R. 32 (Bkrtcy.D.Mass. 2002) ("In this case, the misrepresentations in the Debtor's Schedules, and the tenuous nature of the Plan with its significant family contributions, coupled with the Debtor's filing of the Motion to Convert to escape the effects of the Chapter 7 Trustee's pending adversary proceedings, constitute circumstances sufficiently extreme to warrant denial of the Debtor's Motion."), *with* In re Carrow, 315 B.R. 8 (Bkrtcy.N.D.N.Y. 2004) ("Whether the Debtor will be able to confirm a chapter 13 plan is left for another day. The court is troubled by the Debtor's apparent $1,000 oversight in her income and has concerns about the proposed monthly gift from a third party to help fund a plan. While these concerns may raise questions of good faith and feasibility relevant

## III. THE RESPONDENTS EXAGERATE THE DANGERS OF CONVERSION.

The respondents suggest that conversion to chapter 13 would result in something akin to a "no man's land", in which the debtor has unfettered freedom to do whatever he wishes with assets of the bankruptcy estate, safe from the searching eye of the chapter 7 trustee and the court. The reality is quite different.

The duties of a chapter 13 trustee are set forth in 11 USC § 1302, and expressly incorporate most of the

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to a future confirmation hearing under § 1325(a)(3) and (a)(6), respectively, they are not yet ripe for judicial intervention.").

It is true that in considering confirmation, the court may consider the debtor's good faith in filing a plan, 11 USC §1325(a)(3). However, as the Keach panel recognized, the bankruptcy court's subjective opinion of the debtor is not relevant in considering good faith. Rather, where a plan complies with the requirements of chapter 13, the court must confirm the plan; the court, itself, is powerless to dictate the terms of a plan, both before and after confirmation. Muessel v. Pappalardo (In re Muessel), 292 B.R. 712, 717 (1st Cir. BAP 2003); Keach. Thus, the proper procedure for the bankruptcy court to follow when presented with a motion to convert pursuant to 11 USC §706 is to ensure that the conditions in the statute (i.e., that the case has not previously been converted and the debtor is qualified to be a debtor under the new chapter) are satisfied, and enter an order converting the case to chapter 13, whereupon the debtor has the opportunity to file a plan and parties in interest have an opportunity to object to the plan or to seek reconversion or dismissal. Fundamentally, this is the procedure followed by the bankruptcy court as reported in In re Cabral, 285 B.R. 563 (1st Cir. BAP 2002). Cabral is distinguishable from the present case, however, because there a plan had been filed and the bankruptcy court had before it evidence from which it could determine whether the plan had been filed in good faith. In Marrama's case, by contrast, no plan had been filed and the court had no basis whatsoever from which it could consider reconversion. Indeed, it did not so consider; it simply decided that the request for conversion had been made in bad faith and refused to allow the conversion.

duties of a chapter 7 trustee. These include the duty to investigate the affairs of the debtor and, if advisable, oppose the debtor's discharge. Furthermore, the trustee has standing to seek conversion or dismissal pursuant to § 1307. The chapter 13 trustee also has some of the duties of a chapter 11 trustee.[4] Thus, in some sense, a chapter 13 debtor is subject to greater supervision than a chapter 7 debtor, particularly because some post-petition assets become property of the estate. 11 USC § 1306. Furthermore, the debtor's assets continue to be property of the estate until the discharge is issued; the fact that property revests in the debtor upon confirmation does not mean that the bankruptcy estate ceases to exist. Barbosa v. Soloman, et al, 235 F.3d 31 (1st Cir. 2000). Thus the respondent's concern (and that of the First Circuit) about conversion potentially harming creditors, or giving the debtor a free hand, are without foundation.

As the court in In re Croston, 313 B.R. 447 (9th Cir. BAP 2004), observed, "Sometimes, a problem debtor surprises everyone and winds up confirming and performing a chapter 13 plan that pays creditors more than they would receive in chapter 7 and leaves everyone better off." The legislative history of §706 makes it clear that Congress wanted debtors to have than chance, and that Congress thought it is in the best interests of creditors to *give* debtors that chance. The respondents have not adduced any sound reason to disregard the congressional judgment on this matter of public policy, reflected by the unambiguous

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[4] Ordinarily a trustee is not appointed in chapter 11 cases, but a trustee may be appointed "for cause." 11 USC §1104.

text of the statute, and confirmed by the legislative history.

## CONCLUSION

The plain language of 11 USC §706 states that a debtor may convert a chapter 7 case to another chapter, so long as the debtor is qualified to be a debtor in the chapter to which conversion is sought and the case has not been previously converted. Neither the court's inherent power nor §105 authorizes deviation from the clear statutory mandate. Furthermore, the respondents' concerns about harm to creditors are wholly unwarranted, especially since the chapter 13 trustee has virtually the same power as a chapter 7 trustee, and the bankruptcy judge remains the ultimate arbiter of the case.

For all of the foregoing reasons, the judgment of the court of appeals should be reversed.

Dated: October 26, 2006

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